

## Message Text

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ACTION EUR-12

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C O N F I D E N T I A L OTTAWA 02933

E.O. 11652: GDS  
TAGS: EFIN, CA  
SUBJECT: RESOLUTION OF OTTAWA-QUEBEC CITY DISPUTE OVER  
SALES TAX

REF: A. OTTAWA 1911 B. OTTAWA 1945 C. OTTAWA 2570  
D. MONTREAL 995 E. QUEBEC 165 F. QUEBEC 193

1. AFTER NEARLY TWO MONTHS OF HASSLING, THE FEDERAL GOVERNMENT AND THE QUEBEC GOVERNMENT ARE NOW ON THE VERGE OF SETTLING THEIR BITTER DISAGREEMENT OVER THE SALES TAX ISSUE. EMPHASIZING THAT THE DISPUTE HAD DRAGGED ON LONG ENOUGH, QUEBEC FINANCE MINISTER PARIZEAU ACCEPTED LATE LAST WEEK A MODIFIED VERSION OF EARLIER FEDERAL COMPROMISE PROPOSALS FOR FINANCING OF CUTS IN PROVINCIAL SALES TAXES. PARIZEAU SAID HE WOULD ACCEPT EITHER AN CDOLS 85 PER CAPITA REBATE ON 1977 FEDERAL INCOME TAXES OR CDOLS 85 CUT IN 1978 INCOME TAXES PLUS CDOLS 9 MILLION TO COVER INTEREST COST TO PROVINCIAL GOVERNMENT OF DELAYED RECOVERY OF TAX REVENUES. BOTH PROPOSALS WOULD RETAIN FEDERAL FINANCING (CDOLS 40 MILLION) OF SELECTED SALES TAX CUTS ALREADY EFFECTED. PARIZEAU FAVORS CUT  
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IN 1978 TAXES, WHEREAS FEDERAL FINANCE MINISTER CHRETIEN WOULD PREFER A REBATE ON 1977 TAXES BECAUSE IT WOULD QUICKLY ADD NEEDED STIMULUS TO THE ECONOMY. AT ANY RATE, THE CHOICE IS NOW CHRETIEN'S.

2. THE PQ GOVERNMENT HAD FLATLY REJECTED CHRETIEN'S INITIAL PROPOSAL, CONTAINED IN THE APRIL 10 BUDGET,

PARTIALLY TO FINANCE ACROSS THE BOARD A TEMPORARY CUT IN PROVINCIAL SALES TAX. THE PQ SCREAMED RAPE OF PROVINCIAL PEROGATIVES AND EMPHASIZED THE MEAGER BENEFITS FOR QUEBEC IN CHRETIEN'S PROPOSALS. THE GOC, ON THE OTHER HAND, FOUND UNACCEPTABLE PQ'S PROPOSAL FOR FEDERAL FUNDING OF SELECTED TAX CUTS AND ADVANCED A SERIES OF COUNTER-PROPOSALS. THE MOST RECENT OF WHICH OFFERED QUEBEC A CHOICE BETWEEN MORE GENEROUS FEDERAL FINANCING OF ACROSS THE BOARD TAX CUTS AND CDOLS 100 PER CAPITA CUT IN 1978 FEDERAL INCOME TAXES (SEE REFTELS).

3. COMMENT: MOST OBSERVERS GIVE CHRETIEN HIGH MARKS FOR HIS EFFORTS TO PROMOTE COOPERATIVE FEDERALISM BY CONSULTING HIS COUNTERPARTS IN THE PROVINCIAL GOVERNMENTS BEFORE HE ANNOUNCED HIS SALES TAX PROPOSAL IN APRIL 10 BUDGET SPEECH. AT SAME TIME, NEARLY EVERYONE AGREES THAT CHRETIEN WAS EXCEEDINGLY NAIVE IN BELIEVING THAT PARIZEAU WOULD GO ALONG WITH THIS PROPOSAL. THEN, WHEN PARIZEAU ANNOUNCED HIS SCHEME OF SELECTED CUTS IN THE SALES TAX, CHRETIEN COMPOUNDED HIS ERROR BY INDICATING THAT THE FEDERAL GOVERNMENT WOULD WITHHOLD THE FEDERAL GRANT ON TAX CUTS BECAUSE THE PQ HAD FAILED TO ACCEPT HIS ACROSS-THE-BOARD FORMULA. AT THIS POINT, CHRETIEN CAME UNDER SHARP ATTACK NOT ONLY FROM THE PQ BUT ALSO THE OTHER PROVINCIAL POLITICAL PARTIES IN QUEBEC, AS WELL AS ALL THE OPPOSITION PARTIES IN OTTAWA. THE EFFECT OF THIS

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UNHAPPY AFFAIR IS THAT CHRETIEN'S IMAGE AS FINANCE MINISTER HAS BEEN TARNISHED AND THE FEDERALIST CAUSE IN QUEBEC HAS BEEN DAMAGED--AT LEAST TO SOME EXTENT.

4. THE FINAL ACT IN THIS DRAMA, HOWEVER, COULD AFFECT THIS OUTCOME. PRIVATELY, CHRETIEN HAS SAID THAT HE BELIEVES THE DIRECT MAILING OF CHECKS HE PLANS TO SEND FROM OTTAWA TO QUEBEC TAXPAYERS, ALONG WITH A PRINTED NOTE FROM HIMSELF, WILL SCORE POINTS BOTH FOR THE FEDERAL GOVERNMENT AND FOR THE FEDERAL LIBERAL PARTY. ON THE OTHER HAND, PARIZEAU, IN ANNOUNCING HIS WILLINGNESS TO COMPROMISE ALONG THE LINES OFFERED BY OTTAWA, HINTED THAT THE QUEBEC GOVERNMENT, WHEN IT RECOVERS THE FEDERAL PAYMENT, PROBABLY THROUGH AN INCOME TAX SURCHARGE, MAY SKEW THE COLLECTIONS IN LINE WITH SOME YET TO BE REVEALED OBJECTIVE. THUS, THE FINAL CURTAIN MAY NOT COME DOWN UNTIL FALL.

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## Message Attributes

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